U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000

OFFICE OF PUBLIC AND INDIAN HOUSING

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MEMORANDUM FOR: PIH – Field Offices

FROM: Milan M. Ozdinec, Deputy Assistant Secretary,
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SUBJECT: Operating Fund and Energy Performance Contracting Guidance

In our continuing efforts to make the Energy Performance Contracting (EPC) Program clear, consistent, effective, and efficient for all who regulate or benefit from it, the Office of Public Housing and Voucher Programs and Office of Field Operations are issuing this memo to clarify the funding sources and incentives that are allowable for use within EPCs.

There are two types of incentives offered for reduced utility consumption. The first is the Rolling Base Consumption Level (24 CFR 990.170). The purpose of the Rolling Base Consumption Level is to encourage PHAs to make management and maintenance decisions that result in energy-efficiency improvements, whether large or small, through the normal course of operation. This incentive is part of a PHA's normal operating subsidy eligibility and results in excess subsidy that decreases over a four year period.

The second type of utility cost reduction incentive are those incentives offered under the EPC program (24 CFR 990.185). To qualify for these incentives, the PHA must obtain third-party financing and ensure that the projected savings are sufficient to cover the costs of the improvements. These are large-scale projects that require effort beyond the normal course of operation.

The OFO-EC has received EPC proposals that combine the two incentive types to increase savings and include more Energy Conservation Measures (ECMs) within an EPC. Under current regulations, this is not allowed. The following sections provide an explanation of this policy interpretation.

***Operating Fund Benefit***

PHAs electing the Add-On Subsidy Incentive will concurrently receive the OFB, but the OFB is not an EPC Incentive. In choosing the Add-On Subsidy Incentive, a PHA receives additional Operating Subsidy to repay any loan(s) and/or yearly costs that it owes to a 3rd party for the project. HUD continues to provide this Add-On Subsidy as planned as long as the utility

consumption savings generated in a given year are equal to or greater than the Add-On Subsidy amount provided by HUD for that year. The utility cost savings are calculated by subtracting the actual utility costs from the baseline utility costs (i.e. costs that would have been expected if the ECMs had not been implemented). The Add-On Subsidy is explained in 24 CFR 990.185 (a)(3).

During the Add-On Subsidy incentive period, the Rolling Base Consumption Level, which is calculated each year based on the average of the prior 3 years' actual utility consumption levels, is not frozen. As a result, a PHA who receives Add-On payments under an approved EPC will also receive what is referred to as the Operating Fund Benefit (OFB) (and sometimes referred to as the 3-Year Rolling Base Incentive or the Rolling Base Normalization Savings), which is described in 24 CFR 990.170(c). The Operating Fund Benefit accrues to any PHA that experiences a reduction in utility consumption levels under the Operating Fund formula. Though the benefit may be triggered by an EPC, it is not an EPC Incentive and cannot be combined with an EPC Incentive.

Under the EPC program, a PHA selects one Incentive for each ECM. In selecting the Add-On incentive, the PHA effectively selects their incentive and also receives payment of savings through the Operating Fund Benefit over four years. Based on regulations, the Rolling Base Consumption Level is reported after the period of consumption (i.e., July 1 – June 30) and there is no provision for estimating consumption in advance of the reporting period.

Further, the regulations for the Add-On incentive clearly distinguish between the calculation of the UEL for purposes of determining operating subsidy formula eligibility and the calculation of the EPC Incentive. The PHA, as required by statute, retains the full use and benefit of the consumption reduction under both the Add-On Incentive payment as well as the 3-Year Rolling Base Incentive.

***EPC Incentives***

PHAs may leverage third party funding to implement energy conservation measures (ECMs) and, in doing so, may be eligible for one or more EPC incentives. As outlined in 24 CFR 990.185 (a), "If a PHA undertakes energy conservation measures that are financed by an entity other than HUD, the PHA may qualify for the incentives available under this section." The incentives referred to here, which are allowable EPC Incentives, are the Frozen Rolling Base Incentive, the Add-On Subsidy Incentive, and the Resident-Paid Utility Incentive. In order for a PHA to become eligible for the EPC Incentives, they must submit an EPC proposal that is compliant with HUD's policies and procedures, and the proposal must be approved.

***OFB and EPCs***

***Funds resulting from the Operating Fund Benefit shall not be included in an approved EPC cash flow.*** The Operating Fund Benefit cannot be used in an EPC to fund additional ECMs for two key reasons: 1) including these funds within the cash flow and financing results in a double EPC incentive subsidy for specific ECMs ; and 2) including the OFB as cash flow implies that the operating subsidy benefit is an income stream that can be used to subsidize ECMs; use of this

money in this way violates the third party financing requirement and results in the improper inclusion of certain ECMs within the EPC.

The Add-on incentive will pay the lesser of annual program costs or savings. Thus, the savings associated with a specific set of ECMs have been considered and the incentive appropriately sized. Those same savings cannot then be used to "purchase" more ECMs given that the PHA has already received the benefit of an EPC Incentive. If the EPC savings were sufficient to allow for the additional ECM's the OFB would not need to be included, and the ECMs could be included in the initial sizing of the contract. Instead, the "purchase" of additional ECMs would be contingent upon additional Operating Subsidy being provided over and above the simple energy savings associated with the initial set of ECMs. This would require that the savings for initial ECMs were captured twice – first to size the add-on payment and next to determine the cash flow from the savings to purchase additional ECMs.

This leads directly to the second consideration. By regulation, the OFB is part of the traditional Operating Fund Formula calculation. The regulations are clear that HUD funds may not be used to receive the benefit of EPC incentives. By using estimates to determine what the OFB could be, the EPC explicitly relies on operating funds to purchase additional ECMs for which the PHA would then receive an EPC incentive. Given that the Department has already provided an incentive for those savings and specific set of ECMs, those particular ECMs would be ineligible for the purpose of sizing an additional incentive payment or further ECMs – for which another EPC incentive would need to be provided.

ECMs in an EPC must be financed with 3rd party funds. Again, using OFB amounts as cash flow within the EPC transaction is a clear indication that HUD funds are being used. Although the OFB is leveraged (financed) this leveraging is contingent on the presumption of using HUD funds within the cash flow after an incentive has already been provided for a set of ECMs.

In the course of conducting EPC reviews, Field Offices are required to immediately contact either PIH MOD or the OFO Energy Center for further guidance if they become aware of proposed EPC documents that identify the use of the Operating Fund Benefit as energy savings.

Please contact Erin Schaefer (Public Housing) at 202.402.6354, Julia Hustwit (Public Housing) at 202.402.4261, or Tony Misercola (Office of Field Operations) at 716.551.5755 with questions.